THE MINIMUM SACRIFICE THEORY OF TAXATION.

IF taxes were voluntary contributions for the support of the state, it would be important that we should recognize some principle by which to determine how much each individual ought to give. Since the payment of such a tax and its amount would be matters for the individual conscience, it would be pertinent to ask what principle of obligation the individual ought to adopt as his rule of action. But since taxes are not voluntary contributions but forced payments, we need not so much to know what the duty of the individual is as what the duty of the state is: not how much the individual ought in conscience to give, but how much the state ought in justice to take from him, and under what conditions the state ought to take it. In the matter of taxation the state alone is the voluntary agent, and consequently the duty of the state alone is to be determined. It is one thing to say that the individual ought to contribute to the support of the state in proportion to the benefit which he receives, or to his ability to pay, or to his faculty, but it is quite another thing to say that the state ought to make him do any of these things.

These two questions, though distinct, may be resolved into one by assuming that it is the duty of the state to make its citizens do whatever they ought in conscience to do. It would still be the duty of the state which would have to be determined, but under such an assumption that duty would be clear whenever we had found out how the individual ought to act. Such was the assumption upon which states acted in an earlier and darker age, but it has generally been abandoned except in discussions of the basis of taxation, and it is time that it was abandoned even here.

It is doubtless true *in some cases* that the state ought to make the individual do whatever his duty requires, as in the payment of a debt or the keeping of a contract, but there are many other cases where the duty of the state has to be determined on other grounds. It may be that each citizen ought to contribute to the support of the church "according as the Lord hath prospered

him," but none of the more advanced nations would think of trying to compel him to do so. It may be the duty of each laborer to join a union, but no state ought to force him into one, much less ought the union to be allowed to appropriate that prerogative of sovereignty to itself. It may be, and very likely is, the duty of each individual "to produce according to his ability and consume according to his needs," but no one but a Marxian socialist would claim that the state ought to make him do so. The illustrations might be multiplied, but enough has been said to show that there are no *a priori* reasons for assuming that because the individual ought to pay for the support of the state according to his ability, for example, that it is therefore the state's duty to make him do so.

It is not to be inferred that the question of taxation is entirely divorced from ethics. Neither is it to be inferred that there are two kinds of moral obligations, one for the individual and the other for the state, nor that the ultimate test of right action is not the same for the one as for the other. A very distinct ethical problem is involved in the question of the apportionment of taxes: *viz.*, what is the duty of the state in the matter? Moreover, there is only one kind of moral obligation, and the same test of right action, whatever that test may be, must be applied in determining the duties of both the individual and the state. But even when a general principle of obligation has been agreed upon, no one is in a position to decide upon the specific duty of either the individual or the state until he knows what would be the general consequences of their various possible acts. Recognizing that each act is, for his purposes, the first link in a chain of causation, he must be able to trace that chain from its initial act to its general results before he can tell whether or not the act in question conforms to his general principle. As applied to taxation, for example, he must know how the effort to collect a certain tax will affect industries and morals and other social interests before he can say whether the state, in levying the tax, would be acting in harmony with the general principle of obligation agreed upon. If, to be more specific, he should find that the attempt to collect a certain tax would discourage certain desirable industries and commendable enterprises, that would be at least a partial reason for con-

demning it. That is to say, if the industry which is suppressed meets the test of the ethical principle, the tax which suppresses that industry cannot possibly meet the same test.

The question of the general principle of obligation lies so far outside the field of economics that one may be justified in borrowing such a principle ready made from the moral philosophers. Let us therefore accept, for purposes of this discussion, the principle of utility, and assume that the state, as well as the individual, ought to promote the general welfare — or the greatest good to the greatest number. How can the state promote the general welfare in the matter of taxation? In discussing the duty of the state the present writer cherishes no illusions as to the nature of the state. Realizing that the state is merely an abstraction, a convenient name for certain forms of joint action on the part of a multitude of individuals, and that the state can have no duties separate and apart from those of the individuals who compose it, yet the duty of the individual in imposing his will upon other individuals through legislation is so distinct from his duty in other matters that it is much more convenient, and fully as accurate, to speak of the former class of duties as if they belonged to the state itself.

The question of the duty of the state in matters of taxation is, of course, to be kept distinct from the question of its duty in the expenditure of revenue after it is raised. By the expenditure of a given revenue the state may, in various ways, add positively to the general welfare. But it may not be so obvious how the state can, in merely collecting revenue, promote the general welfare. There are certain ways of collecting revenue which are generally believed, and no doubt correctly, to positively promote well being. When, for example, a tax or a license suppresses or holds in check an industry which is regarded as more or less deleterious, such a tax or license meets the utilitarian test, and is justified only because it meets that test. Writers on taxation generally, even those who uphold the benefit theory or the faculty theory, accept this as a justification, even though it does not conform to their special canon of justice. But if the general utilitarian principle, or the general welfare argument, can, in this special case, override their special canon, why may it not in other cases as well?

It is at least an admission that the general utilitarian test is a more fundamental test than that of their special canon. If so, the more fundamental test ought to be applied in all cases.

While, as already suggested, there are certain taxes whose collection adds to the public welfare by suppressing undesirable industries, yet, generally speaking, the collection of a tax is in itself an evil. It is the cost which we have to undergo for the advantages which may be secured by means of the revenue after it is collected. Since a tax is, speaking thus generally, an evil, a burden, a sacrifice imposed, it is obvious that the utilitarian principle requires that that evil, that burden, that sacrifice, shall be as small as possible in proportion to the revenue secured. When the taxes are so levied and collected as to impose the minimum of sacrifice, and the revenue so expended as to confer the maximum of advantage, or when the surplus of advantage over sacrifice, of good over evil, is at its maximum, the state has fulfilled its obligation completely: it has met the utilitarian test.

If it is once admitted that the state's obligation in the matter of taxation is to be determined on the basis of a broad principle of public utility, then it is apparent that the argument in favor of either the benefit theory or the faculty theory must be reconstructed. Instead of basing the argument upon the duty of the individual, as is usually done,[1] the upholder of either of these theories must show that if the state should apportion taxes according to benefits received, in the one case, or according to ability to contribute, in the other, such apportionment would impose the least burden, all things considered. This is possibly the subconscious basis of the arguments of those writers who have championed either of these theories, but it does not seem to have been explicitly recognized by any of them. The champion of the faculty theory, for example, may conceivably have reasoned somewhat as follows:

Major Premise. The burdens of taxation ought to be so distributed as to involve the least possible sacrifice on the part of the community as a whole.

[1] If such is not the argument, then the leading expounders of these theories are at least guilty of inaccurately expressing their views.

Minor Premise. When each individual contributes in proportion to his ability, the whole burden of taxation is most easily borne — *i.e.*, with the minimum of sacrifice.

Conclusion. It is the individual's duty so to contribute.

Granting the premises, the conclusion follows as a matter of course, so far as the individual's duty is concerned; but, as we shall see later, the minor premise is not sound, and, as we have already seen, the conclusion is not conclusive so far as the duty of the state is concerned. For, whatever might be true if all men were willing to contribute according to their ability, the fact is that they are not willing so to do. Being unwilling, they will resort to various methods of avoiding such contribution. The attempt of the state to compel them to contribute according to their ability will not be without injurious results: it will cause various changes in the direction of business enterprise. One of the ways of avoiding the necessity of paying a tax is to avoid the occasion which the assessor, acting under the law, seizes upon as a pretext for collecting a sum of money. If, for example, the possession of a certain kind of property is such an occasion, men will tend, within certain limits, to avoid the possession of that kind of property. In so far as men generally try to avoid the possession of such property, or to avoid the other occasions for which the assessor is on the look-out, in so far is industry and enterprise disturbed and readjusted. These disturbances and readjustments may be more or less injurious, or more or less beneficial. If some taxes are to be approved because they repress certain undesirable industries, others must on the same reasoning, be condemned because they repress desirable industries. Since almost every tax has some effect in determining the direction of business enterprise, it is obvious that such considerations must enter into the determination of the duty of the state. The matter is therefore not settled when we have found out what the individual ought to do.

By an argument precisely similar to, though somewhat sounder than, that in favor of the faculty theory of taxation, the socialist could support his claim that the state ought to assume the direction of all industry and apportion to each individual his work and his income.

Major Premise. The individual ought to work for the economic welfare of the whole people.

Minor Premise. If each individual would voluntarily work according to his ability and consume according to his needs, the economic welfare would be promoted in the highest degree.

Conclusion. It is the duty of every individual to produce according to his ability and consume according to his needs.

Both the premises are probably sound, and, if so, the conclusion follows as a matter of course; but like the former argument it is inconclusive when applied to the question in hand, which is: What ought the *state* to do? This question is complicated in both cases by the fact that individuals are not willing to do what the conclusion points out as their logical duty, and will therefore adopt methods of avoiding such necessity if the state should attempt to impose it upon them. Such an attempt would therefore produce unlooked for, and, it is generally conceded, highly undesirable consequences. All this amounts to saying that it is not the duty of the state to try to do anything which it cannot accomplish, or in trying to accomplish which it would work mischief. What is here affirmed regarding the state is equally true of individuals. It is, for example, in the opinion of the present writer, highly desirable that all who read this article should agree with its conclusions, but even he does not consider it any one's duty to try to force them to do so — for the simple and only reason that such an attempt could never succeed, or if it did, it would produce other results more undesirable even than disagreement.

McCulloch alone among the leading writers on taxation seems to have grasped this fundamental truth, when he wrote:

It would, no doubt, be in various respects desirable that the inhabitants of a country should contribute to the support of its government in proportion to their means. This is obviously, however, a matter of secondary importance. It is the business of the legislator to look at the practical influence of different taxes, and to resort in preference to those by which the revenue may be raised with the least inconvenience. Should the taxes least adverse to the public interests fall on the contributors according to their respective abilities, it will be an additional recommendation in their favor. But the *salus populi* is in this, as it should be in every similar matter, the prime consideration; and the tax

which is best fitted to promote, or least opposed to, this great end, though it may not press quite equally on different orders of society, is to be preferred to a more equal but otherwise less advantageous tax. . . . The distinguishing characteristic of the best tax is, not that it is most nearly proportioned to the means of individuals, but that it is easily assessed and collected, and is, at the same time, most conducive, all things considered, to the public interests.[1]

Far from ignoring all ethical considerations, as Bastable suggests,[2] this is a distinct recognition of an ethical principle more definite and more fundamental than any which Bastable himself recognizes in his discussion, or shows any signs of being aware of.

Leaving out of consideration for the present all benefits which the levying and collecting of a tax may confer, such as the suppression of an undesirable industry or the deepening of the taxpayer's interest in the affairs of the state, let us turn our attention to the sacrifices involved. There is, of course, to be considered the direct sacrifice on the part of him who pays a tax. Having his income curtailed by the amount of the tax, his power to consume, or to enjoy the use of wealth, is correspondingly reduced. This form of sacrifice is the most prominent, and has, naturally enough, generally appealed most strongly to writers on taxation. But there is also another form of sacrifice quite as important and fully as worthy of attention. Any tax which represses a desirable industry or form of activity not only imposes a sacrifice on him who pays it, but also upon those who are deprived of the services or the products of the repressed industry. Taxes should therefore be apportioned in such a way as to impose the smallest sum total of sacrifice of these two kinds.

While it is essential that both forms of sacrifice should be considered before reaching any final conclusion as to the best system of taxation, nevertheless the preliminary discussion may be facilitated by first considering them separately. If one were to consider only the first and more direct form of sacrifice, with a view to determining how the total sacrifice of this kind could be reduced to a minimum, he would be driven to conclude in favor of a highly progressive rate of taxation on incomes, with a somewhat

[1] Taxation and the Funding System, London, 1845, p. 19.

[2] Public Finance, London and N.Y., 1895, p. 314.

higher rate on incomes derived from more permanent sources, such as secure investments, than upon incomes from insecure sources, such as salaries. From the gross income which comes to him in the form of a salary, the receiver must make certain deductions in the way of insurance premiums, *e.g.*, to provide for the future, before he is on a level, in point of well being, with one whose net income comes to him from a permanent investment. The man with a salary of five thousand dollars would be no better off than another with an income of four thousand from a permanent investment, if the former would have to spend one thousand dollars of his salary in life insurance premiums in order to provide as well for his family as the latter's family would be provided for by the investment itself. Under these conditions, the sacrifice involved in the payment of an equal amount to the state would be equal, though the nominal incomes are unequal.

Leaving such matters out of consideration, a highly progressive rate of taxation would be necessary in order to secure the minimum of sacrifice, and for the following reasons. In the first place, a dollar is worth less, generally speaking, to a man with a large income than to a man with a small income, and a dollar taken from the former imposes a smaller sacrifice than a dollar taken from the latter. Moreover, if after the first dollar is taken from the first man, his income is still greater than that of the second man, the taking of a second dollar will occasion him less sacrifice than would the taking of a first dollar from the second man; so that if only two dollars were to be raised, they should both be taken from the first man. Applying this principle rigorously, we should continue taxing the largest income until it was reduced to such a level that the last dollar of the remaining income was worth as much to its owner as the last dollar of the next largest income is worth to its owner, and then only should we begin to tax the latter at all. Then the two should be taxed until they were reduced to a similar level with respect to the third largest, before the third largest is taxed at all, and so on until a sufficient revenue is raised.[1]

[1] For a fuller discussion of this point, see an article by the present writer on "The Ethical Basis of Distribution and its Application to Taxation," in *The Annals of the American Academy of Political and Social Science*, July, 1895.

Such an application of the principle involves the assumption that wants are equal, which, though obviously not true, approximates more nearly to the truth than any other working assumption that could possibly be invented. Since the state must collect a revenue, it must have some definite assumption upon which it can proceed. The question is not, therefore, whether men's wants are equal, but whether there is any rule of inequality of wants upon which the apportionment of taxes could be made with a nearer approximation to the truth. If there be such a rule, it has not yet been discovered. To assume, for example, that the man whose income is greater than five thousand has correspondingly greater wants than the man whose income is less than five thousand, would be obviously unsafe, because there are even chances that the opposite would be true. Where the chances are even on both sides, it is safer to assume equality. Of a given number of men of the same age and the same general standard of health (by way of illustration) it is obviously untrue to assume that they will all live the same number of years, yet it is nearer the truth to assume that than any other definite workable principle. Consequently the life-insurance company acts justly when it assumes that they will live the same number of years, and apportions their premiums accordingly.

This in no way ignores the fact that wants expand with the opportunity of gratifying them. This objection, however, could only apply at the time when the tax was first imposed. At such a time it would doubtless be true that the five thousandth dollar taken from a man with an income of ten thousand would occasion him a greater sacrifice than the taking of the first dollar from an income of five thousand dollars would occasion its owner. But the reasons for this are twofold. In the first place, by taxing the first man so heavily the state would be depriving him of so many things which he was accustomed to enjoying that by the time the five thousandth dollar was reached, the taking of each particular dollar would be keenly felt. The last dollar of his remaining income would represent a greater utility to him than would the last dollar of the five thousand dollar income to its owner. In the second place, by taxing the second man so lightly as compared with his present taxes, the state would be allowing

him to consume some things to which he had not become accustomed. The taking of the particular dollar in question would not involve a very high sacrifice, for the reason that it would deprive him only of some enjoyment which had not yet entered into his standard of living. But both these reasons would disappear after the new tax had been in operation for a generation, or long enough to bring the standards of living of the two men to the same level.

Drastic as this method of taxation would be, yet, the writer contends, this is the method which would be logically forced upon us if we should adopt the utilitarian test, and should, in applying it, have regard only to the direct sacrifice on the part of those who pay the taxes, ignoring the indirect forms of sacrifice which a system of taxation inevitably imposes. J. S. Mill, who advocated equality of sacrifice as the rule of justice in taxation, was guilty of faulty reasoning on this point, doubtless because he had not made the analysis which subsequent writers have made into the nature of wants and their satisfaction. He was too good a utilitarian to advocate equality of sacrifice if he did not believe that it would involve the least sacrifice on the whole. This is shown by the following quotation, the italics of which are mine.

> For what reason ought equality to be the rule in matters of taxation? For the reason that it ought to be so in all affairs of government. As a government ought to make no distinction of persons or classes in the strength of their claims on it, whatever sacrifice it requires from them should be made to bear as nearly as possible with the same pressure upon all, *which, it must be observed, is the mode by which the least sacrifice is occasioned on the whole.* If any one bears less than his fair share of the burden, some other person must suffer more than his share, and the alleviation to the one is not, *caeteris paribus*, so great a good to him, as the increased pressure upon another is an evil.[1]

The last proposition in the above quotation would be true only of persons whose incomes were approximately equal. If A's income is twice as great as B's, or, to state it more accurately, if A's income were enough greater than B's so that a dollar is worth half as much to A as it is to B, then equality of sacrifice would be

[1] Principles of Political Economy, bk. v, ch. ii, sec. 2.

secured by making A pay twice as many dollars as B: by collecting $100, for example, from A and $50 from B. But the last dollar of A's remaining income would still be worth less to A than the last dollar of B's remaining income is worth to B: and the last dollar taken from A would occasion him less sacrifice than the last dollar taken from B has occasioned him. Then by taking more than $100, say $110, from A, and less than $50, say $40, from B the same revenue would be raised with a smaller sum total of sacrifice, for the gain to B by this change would be greater than the loss to A. This will appear at once to any one who at all understands the principle of marginal utility. The only conclusion one can draw is that the least sum total of direct sacrifice is secured, not by equality of sacrifice, but by equality of *marginal* sacrifice. Equality of marginal sacrifice would be secured by so apportioning taxes that, as a general rule, the last dollar collected from one man should impose the same sacrifice as the last dollar collected from any other man, though the total amount collected from each man might impose very unequal total sacrifices.

We are now in a position to test the validity of the minor premise in the argument on page 70: *viz.*, if each individual would voluntarily contribute in proportion to his ability, the whole burden of taxation could be most easily borne — *i.e.*, with the minimum of sacrifice. If one's ability is assumed to be measured by one's income, real and potential, and to vary with that income, then the minimum of sacrifice would not be secured by each one's paying according to his ability. If the rich would volunteer to pay more than in proportion to their ability, allowing the poor to pay less than in proportion to their ability, the burden would be more easily borne — *i.e.*, with less sacrifice — than if all should pay proportionally. As a statement of individual obligation, even, the faculty theory is untenable, unless modified and defined more rigidly than has yet been done. From the strictly utilitarian standpoint, the individual who measures his obligation to society by his total income is less to be commended than the individual who determines whether he has fulfilled his social obligations by considering, not how much he has given, but how much he has left. The latter type of individual

is well illustrated by the example of that religious and philanthropic leader who found, early in life, that he could live in comfort and maintain his maximum efficiency by the expenditure of a certain small income. Later in life, as his income increased, he continued living on his earlier income, devoting all his surplus to the service of society. This is mentioned merely by way of further elucidation of the proposition that if there were no indirect consequences of the attempt to collect taxes, the utilitarian test would require an enormously high rate of progression in the apportionment of taxes, and that, if the state were able to apportion and collect taxes on this basis, it would only be making individuals do what they ought to do voluntarily.

But there are indirect results, the most important of which is, as already pointed out, the repression of certain desirable industries and enterprises. The importance of this consideration becomes apparent when we reflect on the probable consequence of a system of taxation so drastically progressive as that suggested above. If a large share of one's income above a certain sum should be seized by the tax collector, it would tend to discourage the effort to increase one's income beyond that sum. In so far as this reduced the energy of the individual in business or professional life, the community would be deprived of his services. This deprivation would be a burden on the people, all the more regrettable because it would not enrich the public treasury in the least.[1]

Such considerations become still more important when we come to the discussion of various forms of taxation, especially the taxation of various kinds of property. Since different kinds of property come into existence in different ways, taxes must affect them differently. A kind of property which is produced by labor, or comes into being as the result of enterprise, may be very seriously affected by a tax. Tax the makers of it and they will be less willing to make it. Tax the owners or users of it and they will be less willing to own or to use it. They will therefore pay less for it, and thus discourage the makers of it as effectively as if the latter had to pay the tax themselves. In either case, there

[1] See also Ross, "A New Canon of Taxation," POLITICAL SCIENCE QUARTERLY, vii, p. 585.

will be less of that kind of property made and used, and some members of the community who would otherwise have enjoyed the use of it will now be deprived of that use. This is a burden to them, and, moreover, a burden which in no way adds revenue to the state. Such a tax is repressive. On the other hand, a kind of property whose existence does not depend upon individual labor or enterprise, will be less affected by a tax. Tax the owner of a piece of land, and, while you make him less anxious to own it, you will not cause him to abandon it. While you lower its price, you do not reduce the amount of land nor deprive the community of the use and enjoyment of anything which it would otherwise have had. Such a tax is not repressive.

As a general proposition, it is safe to say that, other things equal, a tax which represses desirable enterprises or activities, and thus deprives the community of the use and enjoyment of certain desirable goods, is more burdensome in proportion to the revenue raised than a tax which does not entail such results. In other words, a repressive tax is more burdensome than a non-repressive tax. A proposition much more to the point is that a tax on any form of property or income which comes into being as the result of the productive industry or enterprise of its owner is more repressive than a tax on any form of property or income which does not so come into being. By productive industry and enterprise is meant such industry and enterprise as adds some thing in the way of utility to the community, and not such as merely costs something to its possessor. Skill in buying land may cost as much study and care as skill in making shoes; but, whereas those who exercise the latter kind of skill increase the number of shoes, it has never been shown that those who exercise the former kind add anything whatever to the community's stock of useful goods. Tax shoe factories and, in so far as it represses the industry, the community will have fewer shoes. Tax the land and the community will not have less of anything than it would have without the tax. What is said of a tax on land could also be said, within limits, of a tax on inheritances. From the standpoint of non-repressive taxation, therefore, both the land tax and the inheritance tax have much to be said in their favor.

Any one who is familiar with the subject of the shifting and

incidence of taxation will see at once that there is a close connection between the repressive effects of a tax and the shifting of it. A tax can be shifted, generally speaking, only when it affects the demand for, or the supply of, and consequently the value of, the thing taxed. The more easily a tax affects the supply or demand, the more easily it is shifted. A tax which does either of these things is repressive: it affects supply by repressing production; it affects demand by repressing consumption. A careful analysis of the conditions under which taxes may be shifted is, therefore, very much to be desired.[1] Such an analysis would enable us to form conclusions as to the repressive or nonrepressive effects of various taxes.

As applied to incomes in general, without regard to their source, a progressive, even a highly progressive, tax will occasion, on the whole, less direct sacrifice to the taxpayers than a proportional tax. A progressive tax is therefore to be commended, unless the rate of progression is made so high as to discourage the receivers of large incomes from trying to increase them. If the rate of progression is so high as this, the indirect form of sacrifice, growing out of the repressive effects of the tax, will counteract, wholly or in part, the reduction in the direct form of sacrifice. A moderately progressive income tax would, therefore, seem to be more desirable than a proportional one. But as between different kinds of income and different kinds of property, the preference should be given to those taxes which fall upon natural products, such as land, rather than upon produced goods, and upon increments of wealth which come to an individual through natural causes over which he has no control — inheritances, for instance — rather than upon incomes earned by the individuals themselves. Such taxes are less repressive than most other special forms of taxation, and therefore occasion less sacrifice of the indirect kind.

THOMAS N. CARVER.

HARVARD UNIVERSITY.

[1] For an attempt in this direction, see the present writer's article on "The Shifting of Taxes," *Yale Review*, 1896. See also Seligman's Shifting and Incidence of Taxation for a brilliant survey of the earlier attempts.